Greater Tompkins County Municipal Health Insurance Consortium

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"Individually and collectively we invest in realizing high quality, affordable, dependable health insurance."

Audit and Finance Committee

Agenda – April 27, 2021
3:30 PM
Zoom Meeting
(see meeting invite or contact consortium@tompkins-co.org for information to join meeting)

1. Call to Order (3:30)	M. Cook
2. Changes to Agenda	
3. Approve Minutes – March 23, 2021	
4. Presentation of External Audit (3:35)	Insero & Co.
a. **Resolution**: Acceptance of 2020 External Audit Report Perfomed by Insero & Co.	
5. Executive Director (4:05)	E. Dowd
a. Report	
b. Introduction of Teri Apalovich	
c. Approval of Medical Claims Audit Final Invoice dated April 15, 2021	
d. Update from Don Barber HCRA project	
e. American Rescue Plan Act of 2021	
6. Financial Update (4:30)	S. Locey
a. Financial Update	
b. Report on large loss claim activity	
c. Accounts Receivable	R. Snyder
d. Expenditure Report	
7. Next meeting Agenda Topics (4:55)	
8. Adjourn (5:00)	

Next Meeting: May 25, 2021

Audit and Finance Committee
Minutes – DRAFT
March 23, 2021
Meeting Held Remotely via Zoom

Present:	Mack Cook, Bud Shattuck, Eric Snow, Rordan Hart, Steve Thayer, Laura Shawley, Jon Munson, Peter Salton
Excused:	Jason Molino
Staff/ Guests:	Elin Dowd, Executive Director; Michelle Cocco, Clerk of the Board; Judy Drake, Board of Directors Chair; Rick Snyder, Treasurer; Don Barber, Consultant; Steve Locey, Rob Spenard, Locey and Cahill; Amanda Anderson, Town of Dryden

Call to Order

Mr. Cook, Chair, called the meeting to order at 3:34 p.m.

Changes to the Agenda

Mr. Cook spoke of the Covid relief funding municipalities will be receiving from the Federal government. He said all local governments are going to receive a vast amount of money; however, there are rules attached to use. Mr. Cook said he and others are looking at whether the increase in this year's and next year's premium would qualify for reimbursement out of this fund. The U.S. Treasury will be weighing in on guidelines but he wanted to let the Committee know this is being explored.

There were no changes to the agenda.

Approval of Minutes of February 23, 2021

It was MOVED by Mr. Snow, seconded by Mr. Cook, and unanimously adopted by voice vote by members present, to approve the minutes of February 23, 2021 as submitted. MINUTES APPROVED.

Executive Director Report

Ms. Dowd provided the Committee with the first quarter Executive Director Report; there were no questions on the report. She referenced the goals and objectives that were a part of the Executive Director's performance review. There were questions raised at yesterday's Operations Committee meeting and a suggestion was made to include racial equity and diversity for the Consortium as a whole. There were no comments on the goals and objectives document that was submitted.

At the request of Ms. Dowd, Mr. Barber reviewed the following comments he circulated to the Committee on the goals and objectives:

"#1 Transition from Old-Style Indemnity and PPO plans: Underwriting work was done a couple years ago by Locey and Cahill which showed that these old plans produce more net income than Metal plans. Currently employers with the Old-Style plans with actuarial values ~96% are incentivizing transitions to the Platinum plan with an actuarial value of ~90%. This transition will have the impact of increasing our claims trends, which we use in creating our budget projections. The goal of digging deeper into this topic is important and could allow the Board to be proactive in maintaining premium rate increase stability. Similar claims trend pressure comes from retirees switching to our Medicare Supplement plan. In this case claim activity remains pretty constant with Medicare being primary, but premium revenue is significantly reduced. You may want to include the retiree plan movement in this analysis.

"When analyzing this underwriting data, we may want to consider the Rx side as well. Since inception, pharmaceutical has been steadily increasing as a percentage of our expenses. ProAct has mentioned several times that a restricted formulary would reduce our Rx spend. Restricted formulary is the brainchild of drug manufacturers to drive more business their way. Hence favorable formularies are incentivized with lower pricing. I believe our metal plans, which allow adjustment of benefits, would be easier to move to a restricted formulary than our Old-Style plans where benefit changes require collective bargaining. Including restricted formulary within the context of the underwriting analysis above may provide a different pathway forward for balancing the underwriting between the different plan structures."

Ms. Drake questioned whether changes could be made to prescription copays in Metal Level Plans without going through collective bargaining negotiations. Mr. Barber recalled when the County and City were transitioning to the Metal Level Plan which allows the Consortium to change the benefits to keep within the actuarial value that unions have to be part of the discussion. Mr. Locey said only the prescription copays are included in the actuarial value. Some of the changes mentioned by Mr. Barber in terms of restricting the formulary would not be included in the actuarial value; however, unions would likely have an issue if something, such as restricting the formulary, was changed outside of the process. Mr. Thayer agreed and said it would likely create issues in the City of Ithaca.

Mr. Locey said over the last few years the Consortium has found that the amount of revenue being produced by some of the Metal Level Plans may not be exactly commensurate with the paid losses and with the older style plans the Consortium is gaining some income in relation to their paid claims. He recognized wanting to move people to more cost-effective plan designs while being careful not to get into a situation of building a deficit. He stressed the importance of making sure that whatever the rate reduction associated with the benefit plans is that there is a commensurate reduction in expense. Ms. Dowd said Mr. Locey has been bringing this issue forward in his monthly reports; this is a goal for 2021 so the Consortium can be well-positioned in the future.

"#4 Growth: It may be worth a discussion about growth. Is there a limit to annual growth that we feel we have the appetite for from the financial side? Further, it may be good to discuss what is an optimal size. This may be a subject of the strategic planning process (#8).

"#9 Investment Manager RFP: The investment laddered approach of our current Investment Manager is a very rudimentary investment model and requires little monitoring and activity by our consultant. In fact, our new Finance Director, after identifying some trusted resources, could do this in-house. The team that interviewed the initial Investment Manager applicants saw other models where the manager actively monitored the yield curve of investment vehicles that met our Investment Policy requirements. With this activity being monitored, trades are made when it is advantageous to capitalize on yield curve changes, which occur quite often, and between investment vehicles. The result is higher return on investments which reduces the pressure on premiums. At this time of low interest rates, I think this extra attention is essential."

Ms. Dowd asked members who have additional comments to submit them to her. She will be working with each committee to move these items forward during the year.

Staffing

Ms. Dowd reported Teri Apalovich has accepted the position of Finance Manager and will be starting on March 29th. She also announced the resignation of Jessica Hobart from the Tompkins County Finance Department; however, she reported Jessica will be continuing to work part-time to help transition finance responsibilities to the Consortium.

Budget Amendment Policy

Ms. Dowd reported the budget amendment policy was approved by the Executive Committee at its last meeting.

Late Premium Payment Policy

Ms. Drake said the Operations Committee discussed this and provided feedback. Ms. Dowd said this Committee had requested feedback on compounding interest and whether efforts continue to move in that direction. Ms. Dowd reviewed examples that were provided in the agenda packet and said it is important to look at where the Consortium should be in the long-run. She said if a member is 90-days in arrears conversations should be taking place. She asked the Committee if members felt a one percent late fee is enough of an incentive to force someone out of being in arrears or if it should be increased or compounded at the end of a month.

Mr. Cook noted that at the present time the Consortium is only charging one percent on the first month a Participant is in arrears. This is one percent a year; therefore, any incentive in subsequent months to pay the arrears has been taken away since there is no interest being attached to the payment after the first thirty days. He also said this is a partnership and questioned if the Consortium wants a partner that can't abide by all the rules of the partnership. After looking into this further he recognizes the extra burden on the Finance Department on trying to put arrears on the sums owed.

Mr. Cook said there is no incentive to pay when no further harm can be done after the first month of being late. Mr. Locey said three entities: Tompkins County Soil and Water Conservation District, Tompkins Cortland Community College, and the Tompkins County Public Library technically are not partners. He suggested that the Consortium look at addressing this and broadening the definition of the municipalities that are allowed to participate under 5g of the General Municipal Law or by amending Article 47 by expanding the definition so that some could be considered their own entity of the Consortium and be subject to the terms of the Municipal Cooperative Agreement (MCA). He noted the Soil and Water Conservation District is already allowed but came in under Tompkins County. He recommended considering having less of these types of arrangements under a municipal employer going forward.

Ms. Dowd said the policy originally came up because there was a department of a member that was late on payment, but the member made them whole in the long-run. She suggested handling that situation separately. She also questioned if a member is over 90-days in arrears, whether having a late policy would be enough to get them back on track. She asked the Committee in going forward if it is important to have this policy in place and if so, what should it look like.

Mr. Salton suggested getting input from the new Finance Manager about this and said he would like the Consortium to strive to be as much like an insurance company as possible.

The Committee did not wish to make any changes to the current policy at this time. Ms. Dowd said this will be included in consideration of management of the membership of the Consortium going forward. This will continue to be looked at and any recommendation that is developed will be brought forward to this Committee.

HCRA (Health Care Reform Act) Tax

Mr. Barber provided a historical overview and stated in 1996 New York State created the Health Care Reform Act as a way to provide for indigent care and not having providers reject folks from care. This tax accounts for over 2% of the Consortium's claims expense. He said while State and federal laws are clear that local governments are exempt from sales and property tax he hasn't been successful in finding what other taxes local governments are exempt from. He said the State has abused these funds and is not using funds for purposes it was originally intended. He believes this makes a case that the Consortium shouldn't be charged for this tax. He and Ms. Dowd have developed a strategy for approaching State representatives and would like input from the Committee. Ms. Dowd commented that the Consortium's legal counsel is also looking into this.

Mr. Cook raised the subject of the Rural Hospital Tax and said local governments and counties are the only ones that are paying for a rural hospital tax twice. He suggested Mr. Barber reach out to Barbara Van Epps at the New York Conference of Mayors.

Financial Report

Mr. Locey reviewed updated financial information and noted in March the Consortium received its first ProAct rebate check for slightly over $515,000. He spoke of the contract count and changes relative to the number of covered lives and things that are being tracked relating to the Medicare Supplement Plan and the splitting of contacts. This has an impact on the paid claims trends and any per contract per month fees that are being paid. Mr. Locey said changes in these numbers largely relate to the Medicare Supplement Program and its splitting; these numbers will continue to be looked at to make sure adjustments are made so that contract fees are appropriate.

Mr. Locey reviewed a graph of the growth of members from 2011 to the current period and said a focus is on the over 65 population which has had the steadiest rate of growth. They are doing an analysis on that to see what impact that will have on claims trends and to make sure that all of the premiums are in line with where they should be from a risk perspective.

Mr. Locey had nothing new to report on revenue. With regard to expense there has been more activity and noted paid claims continued to be well below budget (22%) in total, drug claims were 5.3% below budget, and CanaRX was 7.7% below budget. He reported they are starting to see claims pick up with other groups and are following this for the Consortium as well. They anticipate seeing an escalation in claims starting in March with possibly higher than normal claims as people begin to catch up on medical visits.

Large Losses

Mr. Locey reviewed the large loss report and said for the history of the Consortium the loss ratio for Stop Loss was 46.43%; therefore, the amount paid out in premium was less than the amount paid out in claims. He called attention to total claims that are being accumulated for people who have claims in excess of $100,000 in a calendar year and how much pressure that is placing on the program. He stated one of the reasons the self-insurance pool was increased was to help alleviate this and said this will continue to be monitored. Another area that is being monitored is the percentage of the population generating total claims; last year 1% accounted for 24% of total claims.

In terms of large losses for 2020, there was one individual who went over the $.5 million deductible; however, this individual had a lasered deductible of $1 million; therefore, it wasn't a claim that the Consortium would have paid. Through February 28th there are no claimants that would fall into the catastrophic claims window; therefore, that Reserve has the $4.5 million in it from last year.

Mr. Locey reviewed Covid-19 information that was provided to the Committee and noted that even though paid claims are still well-below budget they are starting to pick up slightly. Also included in the information provided was information paid out by the program for Covid-related services. Through February 28th the spend was $2.1 million on services based on information received from BlueCross BlueShield on hospital, medical, and surgical services. This information did not include any drug-related information.

Accounts Receivable

Mr. Locey reviewed the aging report and said as of March 16 there was very little showing in terms of late payments.

Next Agenda Items

The next agenda will include a discussion of Covid-relief and a report on the external financial audit.

Adjournment

The meeting adjourned at 4:42 p.m.

Respectfully submitted by Michelle Cocco, Clerk of the Board

RESOLUTION NO. AFC 001-2021 – ACCEPTANCE OF 2020 EXTERNAL AUDIT REPORT PERFORMED BY INSERO & CO.

WHEREAS, the Board of Directors entered into a contract for auditing services with Insero & Co. (CDLM), for the purpose of conducting an external audit of the Consortium's financial records for fiscal year 2020, now therefore be it

RESOLVED, on recommendation of the Audit and Finance Committee, That the 2020 external audit report prepared and presented to the Audit and Finance Committee by Insero & Co. (CDLM) is hereby accepted.

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BMI Audit Services

Invoice Date	Invoice #
04/14/2021	INV-6571

BMI Audit Services Holdings, LLC
P.O. Box 989
South Bend, IN 46624
Federal Tax ID: 38-4091484
Ph: 574-234-7780

Bill to:
Greater Tompkins County Municipal Health Insurance Consortium
125 E. Court Street
Ithaca, New York 14850

Terms	Due Date
Net 10	04/24/2021

Item	Description	Amount
HCS-001	Final Invoice for Medical Claims Audit, as outlined in Audit Services Agreement. - Executive Report released on 4/7/2021.	$4,150.00

TOTAL $4,150.00

Make all checks payable to: BMI Audit Services

ACH information available upon request
Contact Drew McIntire: dmcintire@bmiaudit.com

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WILMINGTON TRUST

MEMBER OF THE M&T FAMILY

April | 2021

Institutional Perspectives

Monthly investment analysis and insights from Wilmington Trust Investment Advisors

ON THE RECORD

A Year That Will Live in Infamy: Onward and Upward

In this issue:

Tony Roth
Chief Investment Officer

March marked the one-year anniversary of the COVID-19-induced bear market low. The past year could not be more unlike anything any of us have ever experienced. And while no two recessions ever repeat, this one doesn't even appear to rhyme with anything we've seen in history. The nature of the exogenous economic shock, the depth and speed of the economic collapse, and the extraordinary monetary and fiscal response make the 2020 recession truly unique.

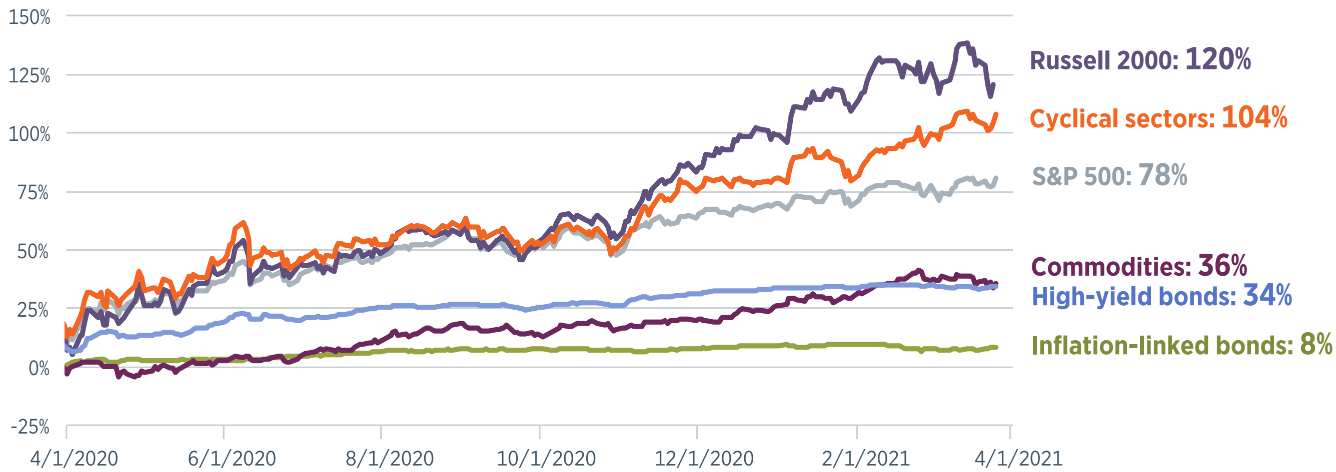
Yet, many aspects of the market response one year out appear fairly "textbook." Equities have rallied significantly off the bottom, with the S&P 500 gaining 78% (including dividends) in the 1-year since March 23, 2020. Small-cap equities have outpaced large cap, delivering 120% total return, according to the Russell 2000 and S&P 500 indices, respectively. Cyclical sectors—that are sensitive to the peaks and troughs of the economy, like energy, materials, industrials, consumer discretionary, and financials—have been the best performers in the S&P 500 index. Commodities, high-yield bonds, and inflation-linked bonds have all delivered strong returns (Figure 1).

As we look ahead to the next year, we remain constructive on equities and have rotated the portfolios to further embrace cyclical and value-oriented equities. We hold overweight positions to equities (including U.S. large cap, U.S. small cap, international developed, and emerging markets), high-yield fixed income, and commodities versus our long-term strategic asset allocation. We fund that with underweight positions to cash, fixed income, and hedge funds.

Continued

Figure 1

Asset class returns since March 23, 2020



Data as of March 25, 2021. Sources: Macrobond, Bloomberg. Cyclical sectors show the performance of an equal-weighted index of S&P 500 energy, materials, industrials, consumer discretionary, and financials sectors. Past performance cannot guarantee future results. Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses such as management fees and transaction costs which will reduce returns.

Equities are certainly pricing in a robust economic recovery, and risks to the economy and markets are present, so we expect equity returns to be more modest going forward but still to exceed those of bonds.

Economic acceleration

We are quite optimistic on the U.S. and global economic trajectories. An acceleration in the pace of vaccine distribution in the U.S. should permit economic reopening to coincide with fiscal stimulus making its way into the hands of consumers, businesses, and municipalities. Bloomberg median consensus estimate is for GDP growth of 5.7% year over year in 2021. We think this is conservative and believe growth could reach 9% based on reasonable assumptions of how much of the recently approved $1.9 trillion of fiscal support and $2.1 trillion in household savings are spent in 2021. The Treasury has already distributed $325 billion of economic impact payments, which should show up immediately in stronger consumer spending.

We believe inflation is likely to increase over the next 12 months, with our base case for headline CPI to settle in around 2.75% year over year in the second half of 2021. However, looking out over the next 12–18 months, we expect an elevated savings rate, pent-up demand for services, supply chain bottlenecks in parts of the world, and accommodative monetary policy to further raise inflation risks. The Federal Reserve has repeatedly telegraphed a desire to let inflation expectations and realized inflation run above its target for a prolonged period of time, which we interpret as indicating no increase in the federal funds rate for at least the next 12 months.

Equities are certainly pricing in a robust economic recovery, and risks to the economy and markets are present, so we expect equity returns to be more modest going forward but still to exceed those of bonds. It is to consideration of these risks—and their related investment opportunities—that I'll devote the rest of this letter.

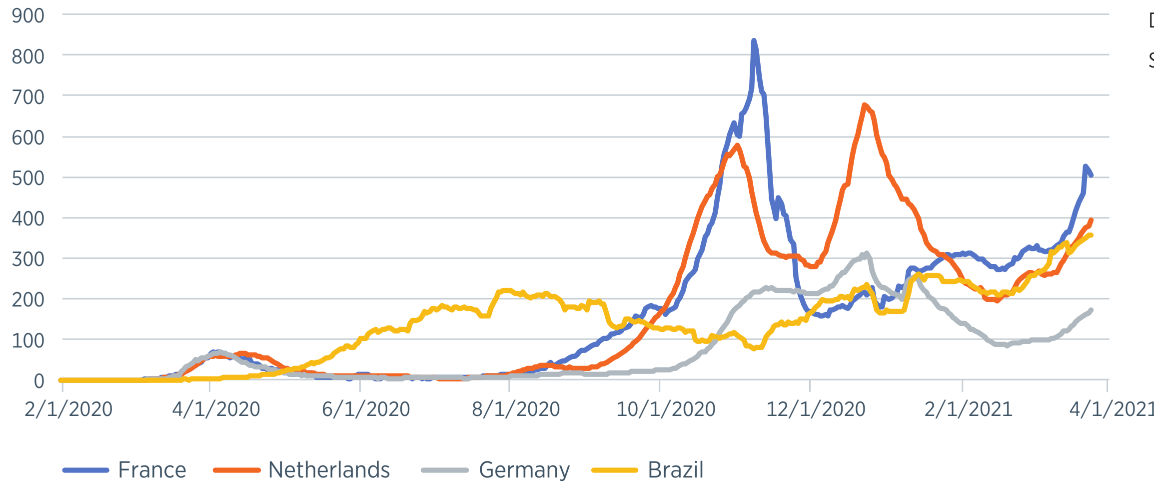
Risks and opportunities

There are three main risks to the economy and markets over the coming months: COVID-19 variants, interest rates, and tax hikes. These risks could pose a greater

Continued

Figure 2

Daily cases of COVID-19 (including variants) per million of population



Data as of March 26, 2021.

Source: Macrobond.

Non-U.S. equities tend to be more levered to global economic activity given higher weightings to cyclical sectors and more reliance on exports, so we expect these equity markets to begin pricing in better earnings projections.

threat should equity market valuations continue to climb, but we also recognize them as presenting interesting investment opportunities.

- **COVID-19 variants**
  As if the original strain did not already present enough of a challenge, it is rapidly mutating around the globe. Scientific research so far suggests these strains—different ones beginning to dominate in different countries—are generally more contagious but not more lethal. The vaccines in distribution appear somewhat less effective at preventing the spread of these variants, but still very effective in preventing the most severe cases linked to hospitalization or death.

  In many other countries, this increased contagion is outpacing vaccinations, resulting in more stringent restrictions on schools, businesses, and social activities (Figure 2). As a result, economic activity in the first half of the year could suffer in Europe, Japan, and some emerging markets, such as Brazil. However, we are confident that these countries will move beyond the virus in the second half of the year as vaccine distribution accelerates. Non-U.S. equities tend to be more levered to global economic activity given higher weightings to cyclical sectors and more reliance on exports, so we expect these equity markets to begin pricing in better earnings projections. They are also much more attractively valued than U.S. markets, with the MSCI Emerging Markets Index trading in the 17th percentile versus the S&P 500 over the last five years, and the MSCI EAFE Index trading in just the 4th percentile. We believe the COVID variant risk presents an opportunity to invest in international equities at attractive levels ahead of a potential performance catch-up.

- **Interest rates**
  The upward move in interest rates has been dramatic and is resulting in one of the worst-ever starts to the year for fixed income returns. The 10-year Treasury yield bottomed after U.S. equities, hitting 0.5% on August 4, 2020. It stands at 1.66% at the time of writing. While a 1.16% move for the 10-year yield over the course of a

Continued

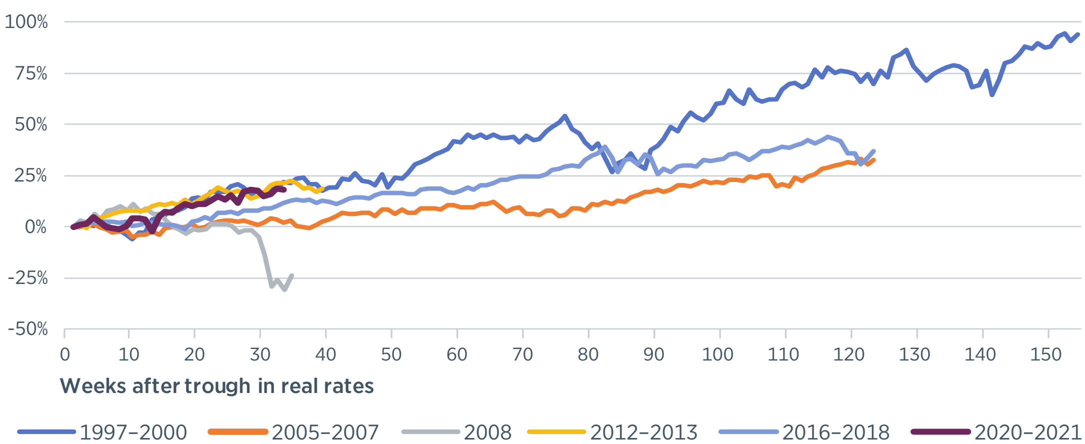
While rates have increased considerably, they are still very low relative to history and present challenges for income-oriented investors.

seven-month period is not unheard of, the relative move of more than 200% is extraordinary. The yield curve has also steepened, and we expect that trend to continue. With the Fed on hold and expectations for growth and inflation resetting higher after the passage of fiscal stimulus, the short end of the yield curve remains anchored while longer-dated interest rates have moved higher. The Fed has shown little interest in stepping in to curb the rise in rates (by, among other things, accelerating or increasing asset purchases). This has spooked equity investors, particularly those of "long-duration" growth equities.

We expect rates to continue to move higher and the yield curve to continue steepening, with the 10-year yield likely reaching 2%–2.25% a year from now. This effectively tightens financial conditions, though modestly, without any action from the Fed. However, we see opportunities for investors. First, an increase in real rates (nominal rates minus inflation expectations) has generally been a favorable backdrop for equities (Figure 3). This month we also rotated our portfolios further into cyclical and value-oriented equities slightly lower on the quality spectrum and trimmed some of our exposure to the growth and lower volatility factors. The economically sensitive cyclical sectors and value equities have historically outperformed in environments of accelerating economic growth, higher interest rates, and a steeper yield curve. While rates have increased considerably, they are still very low relative to history and present challenges for income-oriented investors. Therefore, we continue to seek opportunities in

Figure 3

S&P 500 cumulative total returns in periods of rising real rates



Source: Macrobond.

Chart shows the cumulative total returns of the S&P 500 during periods over the past 25 years in which the inflation-adjusted U.S. 10-year Treasury yields rose by 100 basis points or more.

Past performance cannot guarantee future results. Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses such as management fees and transaction costs which will reduce returns.

	Months	Rise in real rates (basis points)	S&P 500 total return	S&P 500 annualized return
Feb 1997–Dec 2000	**35**	107	91.3%	24.7%
Feb 2005–Jun 2007	**29**	126	29.8%	12.2%
Mar–Oct 2008	**8**	213	-24.1%	-33.3%
Dec 2012–Sep 2013	**10**	178	17.5%	26.0%
Jul 2016–Nov 2018	**29**	120	40.1%	14.8%
Aug 2020–Mar 2021	**8**	44	18.9%	32.0%
Average	**20**	**131**	**28.9%**	**12.7%**

Continued

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Industrial equities may become more attractive under a scenario of infrastructure spending paired with tax hikes, as they would be one of the sectors we would expect to take less of a hit from an increase in the corporate and GILTI tax rates

dividend equity and covered-call strategies (the latter of which employs a strategy of selling call options on a security to generate extra income). For more on our portfolio strategies, please see the replay from our recent webinar: "Adapting Portfolios as Rates Rise."

- **Tax increases**
  It is still too early to speculate on specific changes to tax policy, but infrastructure spending is a key tenet of President Biden's agenda and one that could require tax increases as a means of offsetting the bill. We expect an increase to personal, corporate, and capital gains tax rates as early as 2021. An increase in the capital gains rate has historically been correlated to lower equity market returns (and obviously lower after-tax returns for taxable investors). President Biden's tax plan from the campaign trail included a higher U.S. corporate tax rate of 28%, increase in the global intangible low-taxed income (GILTI) to 21%, and minimum corporate tax rate of 15%. All in, this could shave 8%–10% off S&P 500 earnings in 2022. However, the Democrats are operating on a razor-thin majority in both houses, so we could see a more moderate or phased-in approach to raising taxes that would be less likely to derail the current bull market.

  Clearly, an increase in the U.S. corporate tax rate would impair U.S. equities at the expense of international, all else being equal. We would note that industrial and material equities may become more attractive under a scenario of infrastructure spending paired with tax hikes, as this would be one of the sectors we would expect to take less of a hit from an increase in the corporate and GILTI tax rates, while also benefiting from a deluge of spending on infrastructure.

The risks outlined above could weigh on overall equities, but we would expect any pullback to be short lived. The "easy money" has likely been made over the past year (though we find it hard to characterize anything about the last year as "easy"). Going forward, we will continue to maintain a long investment horizon, look for opportunities in market rotations or pullbacks, and seek attractive risk-adjusted returns that help our clients achieve their financial goals.

Please take the time to read the following "In Focus" article by Steve Norcini, our head of sustainable investing, and manager of our ESG equity portfolio strategy (and yes, he'll explain "ESG" and the many acronyms associated with it). ESG criteria are not only essential to Steve and his team in selecting companies for our equity strategy; it was also a key trend we highlighted in our 2021 Capital Markets Forecast.

Also, watch for an invite to our April 21 webinar on the subject, where I'll be joined by Steve and other senior team members to discuss what investors need to know about this important space.

Until next month,

Tony

Tony

Continued

Current tactical asset allocation

	Tactical tilts	− NEUTRAL +	Positioning
Equities	U.S. Large Cap	○ ○ ○ ○ ● ○ ○	Overweight
	U.S. Small Cap	○ ○ ○ ○ ● ○ ○	
	International Developed	○ ○ ○ ○ ● ○ ○	
	Emerging Markets	○ ○ ○ ○ ○ ● ○	
Taxable Fixed Income	Investment Grade	○ ● ○ ○ ○ ○ ○	Underweight
	High Yield	○ ○ ○ ○ ● ○ ○	
Real Assets	Inflation-linked Bonds	○ ○ ● ○ ○ ○ ○	Overweight
	Global REITs	○ ○ ○ ● ○ ○ ○	
	Other/Commodities	○ ○ ○ ○ ● ○ ○	
Alternatives	Equity long/short hedge	○ ○ ● ○ ○ ○ ○	Underweight
Cash		○ ○ ● ○ ○ ○ ○	Underweight

IN FOCUS

Sustainable Investing:
For the Benefit of Principal and Principles

Steve Norcini
Head of Sustainable Investing
and Senior Portfolio Manager

At a glance:

- **Sustainable investors seek to maximize risk-adjusted returns through the implementation of ESG criteria, which tend to focus the analysis on long-term risks and opportunities**
- **Sustainable funds have done well since they came into prominence over the last several years, in particular, 2020, where ESG exposures added significantly to performance**
- **According to a 2019 Morningstar study, 41 of 56 indices studied outperformed their non-ESG equivalents[1] since inception**
- **The attractive characteristics of ESG companies overall have room to run from a price appreciation standpoint**

What began decades ago as a fringe notion of investing to make the world a better place has soared in popularity in recent years. To understand what's meant by sustainable investing and the efforts to align one's values with financial goals, we turned to Steve Norcini, head of sustainable investing for Wilmington Trust, and manager of its ESG equity portfolio strategy.

Q. Let's start out by defining terms. We hear about ESG, SRI, SI … can you provide an overview of what they all mean and how they're related?

A. We use sustainable investing (SI) as our umbrella term for all forms of investing that focus on long-term sustainability and ethical behavior of companies. Socially responsible investing (SRI) avoids investing in companies and industries that run contrary to an investor's set of values. A quick history lesson first, to give some context to the acronyms. Back in the mid-1900s, SRI, came into play with the notion of eliminating "sin stocks"—those related to alcohol, tobacco, or gambling—from investment consideration, as some considered them morally objectionable. You can still exclude or screen out certain industries that don't align with your values, but the field has expanded to a broader focus on the more *inclusionary* ESG investing, which considers environmental, societal, and governance criteria to help achieve financial objectives.

The "E," or environmental pillar, refers to actions that reflect positive stewardship of our planet—and covers how resources are allocated, looking at a wide range of factors, such as the extent of companies' (and their suppliers') carbon footprints, how they approach recycling, water usage, pollution, etc. The "S" or social pillar focuses on the management of *all* stakeholders—including employees, clients, shareholders, suppliers, and the communities they serve. For example, it encourages behavior such as a focus on employee health and safety as well as diversity in hiring. The "G," or corporate governance pillar, relates to whether a company ensures incentives of all stakeholders are aligned to maximize the long-term value of the company. ESG criteria provide a lens to assess the long-term risks and opportunities of a firm. It can also provide greater diversification with the potential to cover a wider range of concerns than traditional SRI strategies. You'll hear many other acronyms and terms as well, such as "socially conscious," "green," or "values-based," "thematic," or "impact investing" but they can all generally be thought of under the blanket term of sustainable investing.

[1] "ESG Investing Performance Analyzed," by Dan Lefkovitz, March 12, 2019; https://www.morningstar.com/insights/2019/03/12/esg-investing-perfor_0

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At the start of 2020, one out of three dollars under professional management in the U.S.—approximately

$17.1 trillion

—employed a sustainable investing strategy, a 42% increase since 2018.

(Source: US Social Investment Forum's 2020 Report on US Sustainable and Impact Investing Trends)

Q. So clearly, sustainable investors want to drive positive change in the world—but they're still seeking an attractive, competitive return on their investment. For a long time, many argued that you couldn't do good *and* do well at the same time. Has that changed or do you have to sacrifice returns to make a positive impact?

A. Sustainable investors are definitely, and appropriately, out to maximize risk-adjusted returns, through the implementation of ESG criteria. And the numbers have shown the ability to do just that. Keeping in mind of course, that past performance is not indicative of future returns, sustainable funds have done well since they came into prominence over the last several years.

Last year was a big year for ESG investing, not only because of the flows into ESG-focused strategies, but also because the market environment was volatile and ESG issues were at the forefront. What we see is that ESG exposures added significantly to performance. In fact, the greater the focus on ESG characteristics, the greater the outperformance for the year, based on a series of indices maintained by global provider MSCI, where the most concentrated MSCI SRI Index outperformed its parent benchmark MSCI ACWI Index by 4% in 2020.

Morningstar studied the performance of 56 indices in which ESG criteria are the primary drivers of security selection and found that 41 of them outperformed their non-ESG equivalents since inception. Looking at how our models performed within the Russell 1000 index, the stocks in the top quintiles (by their ESG scores) outperformed the Russell 1000 index by 6% in 2020. We see that high ESG stocks have significantly better profitability, lower volatility, lower cost of capital—with higher quality scores and governance risk scores, as assessed by reputable evaluators. Higher quality (as well as lower volatility) tends to offer some downside protection. For example, between February 20 and March 20 of 2020, the Russell 1000 corrected by 32%; but within that correction, higher-quality, higher-scoring ESG stocks outdid low-quality, low scorers by over 7%.

Finally, our own internal research suggests that these attractive characteristics are not yet fully priced into the multiples we pay for these companies; put another way, these companies overall have room to run from a price appreciation standpoint.

Q. The $1 million question is, how are sustainable funds able to outpace broader stock market indices?

A. We believe it's because sustainable investing is about focusing the investment process on the long-term risks and opportunities in the marketplace. The integration of ESG principles into investment processes tends to focus the analysis on these long-term risks and opportunities. Historically, "long term" has been consistent with one complete market cycle. However, the marketplace is much more dynamic than that, which requires management teams to think far out into the future. Companies that are serious about ESG have shown themselves to be better positioned for

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Mark your calendars for our important webinar on April 21 at 1:00 PM ET,

"ESG Strategy Returns: Why We Believe They're Sustainable,"

where Steve, Tony, and other senior team members will explore ESG investing strategies that aim to reap competitive returns while putting money to work in a way that aligns with investor values.

Invitation coming soon to book a front seat for this engaging conversation.

certain unexpected risks, such as increased government regulations, evolving consumer preferences, and yes, even pandemics, which is essential to maximize risk-adjusted returns.

Q. So, in the year 2020, which will be remembered as the toughest in decades, sustainable investing grew leaps and bounds. Why? How do the events of 2020 relate to sustainable investing?

A. In 2020, investors got a first-class education on tail risks, which refers to the risk of assets deviating more than a certain degree from their current price. Tail risk events—such as the pandemic and civil unrest we witnessed last year—are very uncommon, but when they occur, they are very impactful to portfolios. They seem to occur once every several decades and are very difficult to predict in terms of timing and severity. There is good evidence that highly rated ESG companies are less susceptible to these risks than their peers. For example, research from MSCI has found that the frequency of tail-risk events was around three times higher for companies that score poorly on ESG metrics compared to their higher-ranking counterparts. Investors seemed to have learned this lesson. One study showed 78% of U.S. investors said they would increase ESG investment as a response to COVID-19.

Q: Steve, as the manager of Wilmington Trust's ESG equity strategy, when you're looking for sustainable companies with solid growth prospects, what do you look for? And how do you know if they're who they make themselves out to be—or if they're just greenwashing, where they only have the appearance of being ESG friendly?

A. Our experienced team has a robust process to identify companies that display superior ESG qualities. We start with a quantitative screen that looks at over 130 different ESG criteria across the market to isolate companies with the qualities that are consistent with our ESG mandate. Drilling down deeper, we perform robust fundamental due diligence on those companies to see if they are just screening well, or if they really meet our high ESG standards. We then construct a diversified portfolio of companies that passes this process to maximize risk-adjusted returns. Finally, we utilize our comprehensive risk management process to help ensure that the expected return on an investment won't be negatively impacted by unanticipated factors.

Q: For those who want to learn more and find out how sustainable investing can be reflected in their portfolios, what's the next step?

A. Like other areas of investing, investors should consult with their advisors, who are familiar with their goals, needs, risk tolerance, and unique circumstances. Taking all those factors into consideration, they can then explore how ESG criteria may be integrated into their portfolios and overall wealth management plan.

ASSET CLASS OVERVIEW

Equities

Andrew H. Hopkins, CFA
Head of Equity Research

AS OF MARCH 31, 2021

	Month	Last 3 months	Trailing 12-month return
S&P 500 Index	4.4%	6.2%	56.3%
Russell 2000 Index	1.0%	12.7%	94.8%
MSCI EAFE Index	2.3%	3.5%	44.6%
MSCI Emerging Markets Index	–1.5%	2.3%	58.4%

Sources: FactSet, Bloomberg. Investing involves risks and you may incur a profit or a loss. Past performance cannot guarantee future results. Indices are not available for direct investment.

What we are seeing now

U.S. equity markets experienced continued upward momentum in March as the strength in cyclicals and defensives outperformed traditional growth with a 4.4% return in the S&P 500 while the more cyclical Russell 2000 Index rose 1.0%. The Russell 1000 Value Index saw an increase of 5.9% while the Russell 1000 Growth Index rose 1.7%. Incremental progress on vaccinations has pushed stocks most affected by the crisis higher and investors have priced in a good portion of the return to normal over the last five months. The yield curve steepened during March with a continued rise in longer-term rates that pressured higher-yielding stocks helped by lower rates during the crisis. The best performance came from utilities, industrials, consumer staples, materials, and real estate. Underperforming sectors included technology, energy, communication services, and consumer discretionary. Valuation is at the high end of historical averages with a 2021 P/E multiple of 22.1x, which adds to the vulnerability of the market. Earnings estimates continue to climb higher with growth of earnings expected to be 21.5% this year with any further upside in earnings helping to absorb the high P/E multiple, allowing the market to potentially rise and the multiple to contract at the same time.

What's changing

Equities continued their strong performance during March as vaccines continued apace. The expected recovery is raising inflation concerns as a more open economy is likely to bring a surge in spending, particularly with the recent $1400 checks sent to most consumers. Another potential $2.25 trillion bill in Congress potentially brings even more liquidity to the fore with the possibility of more inflation than the market has seen for some time, which may pressure equity market valuation. Along with the spending will most likely come higher taxes for corporations and higher-income individuals. The upward move in longer-term Treasury yields has only accentuated the fears of future inflation and pressure on long-duration asset values. Equity earnings estimates continue to push to the upside, especially for the cyclical sectors where earnings were devastated last year.

What we expect

With good progress being made with vaccinations, we expect the recovery to play out positively throughout the rest of the year with potential upside to earnings expectations potentially offset by higher tax rates. The year-over-year comparison will be easiest in the second quarter due to the shutdowns that occurred in 2020. This will result in higher inflation as the comparison to the lull in activity in the prior year, but we expect this boost in inflation levels to be transitory and moderate as the year progresses. Looking to 2022, we expect the pace of growth to moderate to a more normal level. The positive influences on productivity should come back as technology investment reasserts its importance in more businesses as it did during the pandemic. While equity valuations remain full and vulnerable to higher interest rates and tax increases, the snapback growth the economy is likely to see through 2021 should help offset this pressure.

Investment Positioning

Portfolio targets effective April 1, 2021, for institutional clients with Private Hedge Funds

Growth & Income

	Strategic Asset Allocation (long term)	Tactical Asset Allocation (short term)
Equities		
U.S. Large-Cap	27.5%	Overweight
U.S. Small-Cap	5.5%	Overweight
International Developed	15.8%	Overweight
Emerging Markets	5.5%	Overweight
Fixed Income		
U.S. Investment Grade–Taxable	24.2%	Underweight
High-Yield–Taxable	3.0%	Neutral
Real Assets		
U.S. Inflation-Linked Bonds	1.0%	Underweight
Global REITs	1.5%	Neutral
Other	1.5%	Overweight
Private Hedge Funds	12.5%	Underweight
Cash & Equivalents	2.0%	Underweight
Total	100.0%	

Note: Totals may differ slightly from the allocation building blocks due to rounding.

TAA, or Tactical Asset Allocation, represents our *current recommendation* for each model strategy.

SAA, or Strategic Asset Allocation, represents our *current benchmark* allocation for each model strategy.

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For an overview of our asset allocation strategies, please see the disclosures.

Source: WTIA.

Disclosures

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Indexes are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs that would reduce returns.

Past performance cannot guarantee future results. Investing involves risk and you may incur a profit or a loss.

An overview of our asset allocation strategies:
Wilmington Trust offers seven asset allocation models for taxable (high-net-worth) and tax-exempt (institutional) investors across five strategies reflecting a range of investment objectives and risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. The seven models are High-Net-Worth (HNW), HNW with Liquid Alternatives, HNW with Private Markets, HNW Tax Advantaged, Institutional, Institutional with Hedge LP, and Institutional with Private Markets. As the names imply, the strategies vary with the type and degree of exposure to hedge strategies and private market exposure, as well as with the focus on taxable or tax-exempt income.

Model Strategies may include exposure to the following asset classes: U.S. large-capitalization stocks, U.S. small-cap stocks, developed international stocks, emerging market stocks, U.S. and international real asset securities (including inflation-linked bonds and commodity-related and real estate-related securities), U.S. and international investment-grade bonds (corporate for Institutional or Tax Advantaged, municipal for other HNW), U.S. and international speculative grade (high-yield) corporate bonds and floating-rate notes, emerging markets debt, and cash equivalents. Model Strategies employing nontraditional hedge and private market investments will, naturally, carry those exposures as well. **Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.**

Allocations:

Each strategy is constructed with target weights for each asset class. Wilmington Trust periodically adjusts the target allocations and may shift away from the target allocations within certain ranges. Such tactical adjustments to allocations typically are considered on a monthly basis in response to market conditions. The asset classes and their current proxies are: large–cap U.S. stocks: Russell 1000® Index; small–cap U.S. stocks: Russell 2000® Index; developed international stocks: MSCI EAFE® (Net) Index; emerging market stocks: MSCI Emerging Markets Index; U.S. inflation-linked bonds: Bloomberg/Barclays US Government ILB Index; international inflation-linked bonds: Bloomberg/Barclays World exUS ILB (Hedged) Index; commodity-related securities: Bloomberg Commodity Index; U.S. REITs: S&P US REIT Index; international REITs: Dow Jones Global exUS Select RESI Index; private markets: S&P Listed Private Equity Index; hedge funds: HFRI Fund of Funds Composite Index; U.S. taxable, investment-grade bonds: Bloomberg/Barclays U.S. Aggregate Index; U.S. high-yield corporate bonds: Bloomberg/Barclays U.S. Corporate High Yield Index; U.S. municipal, investment-grade bonds: S&P Municipal Bond Index; U.S. municipal high-yield bonds: Bloomberg/Barclays 60% High Yield Municipal Bond Index / 40% Municipal Bond Index; international taxable, investment-grade bonds: Bloomberg/Barclays Global Aggregate exUS; emerging bond markets: Bloomberg/Barclays EM USD Aggregate; and cash equivalents: 30-day U.S. Treasury bill rate.

Continued

Disclosures Continued

All investments carry some degree of risk. Return volatility, as measured by standard deviation, of asset classes is often used as a proxy for illustrating risk. Volatility serves as a collective, quantitative estimate of risks present to varying degrees in the respective asset classes (e.g., liquidity, credit, and default risks). Certain types of risk may be underrepresented by this measure. **Investors should develop a thorough understanding of the risks of any investment prior to committing funds.**

Quality ratings are used to evaluate the likelihood of default by a bond issuer. Independent rating agencies, such as Moody's Investors Service and Standard & Poors, analyze the financial strength of each bond's issuer. Ratings range from Aaa or AAA (highest quality) to C or D (lowest quality). Bonds rated Baa3 or BBB and better are considered **Investment Grade.** Bonds rated Ba1 or BB and below are **Speculative Grade** (also **High Yield**.)

Definitions:

Alpha is a measure of performance on a risk-adjusted basis. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.

Equity risk premium is the extra return that's available to equity investors above the return they could get by investing in a riskless investment like T-Bills or T-Bonds or cash.

Event-driven hedge fund strategies attempt to take advantage of temporary stock mispricing before or after a corporate event takes place. An event-driven strategy exploits the tendency of a company's stock price to suffer during a period of change.

HFR® (HedgeFundResearch) Indices are the established global leader in the indexation, analysis and research of the hedge fund industry.

LIBOR is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another.

Macro hedge fund strategies generally focus on financial instruments that are broad in scope and move based on systemic or market risk (not security specific). In general, portfolio managers who trade within the context of macro strategies focus on currency strategies, interest rates strategies, and stock index strategies.

MSCI AC Asia ex Japan Index captures large- and mid-cap representation across two of three developed markets countries (excluding Japan) and nine emerging markets countries in Asia. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI China Index captures large- and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). The index covers about 85% of this China equity universe. Currently, the index includes large-cap A and mid-cap A shares represented at 20% of their free float adjusted market capitalization.

MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the U.S. and Canada. With 902 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI EAFE Growth Index captures large- and mid-cap securities exhibiting overall growth style characteristics across developed markets countries around the world, excluding the U.S. and Canada.

MSCI EAFE Value Index captures large- and mid-cap securities exhibiting overall value style characteristics across developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index captures large- and mid-cap representation across 26 emerging markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI Europe Index captures large- and mid-cap representation across 15 developed markets (DM) countries in Europe. The index covers approximately 85% of the free float-adjusted market capitalization across the European DM equity universe.

MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market. The index covers approximately 85% of the free float-adjusted market capitalization in Japan.

MSCI United Kingdom Index is designed to measure the performance of the large- and mid-cap segments of the UK market. The index covers approximately 85% of the free float-adjusted market capitalization in the UK.

Relative value hedge fund strategies cover a variety of low-volatility trading strategies with the consistent theme of attempting to reduce market risk, i.e., the manager seeks to generate a profit regardless of which direction the markets are moving. All relative value strategies minimize market risk by taking offsetting long and short positions in related stocks, bonds, and other types of securities.

S&P 500 index measures the stock performance of 500 large companies listed on stock exchanges in the U.S. and is one of the most commonly followed equity indices.

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